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SUBJECT: CROATIA 2008 INVESTMENT CLIMATE STATEMENT (PART I)

REF: STATE 158802

[¶1.](#) Summary: Croatia has enjoyed steady growth in foreign investment over the last several years, buoyed by a growing economy, low inflation, a stable exchange rate and developed infrastructure. With progress towards membership in NATO and the European Union well advanced, Croatia has taken a leading position in the region, with the expectation that Euro-Atlantic integration will provide further stimulus for investment and growth. However, despite progress in economic and administrative reforms, problems remain. These include a judiciary plagued by case backlogs, overly complex bureaucracy, corruption and the country's relatively high costs. Nevertheless, many foreign investors are prospering in this growing market. End Summary.

A.1 Openness to Foreign Investment

[¶2.](#) Croatia is open to foreign investment. The Croatian government has set a goal of increasing foreign investment and has undertaken incremental measures to improve the investment climate in the country, hoping to build on recent positive trends that include a stable macroeconomic environment and future NATO and EU membership.

[¶3.](#) Croatia's legal framework accords national treatment to foreign and domestic investors. The Internet website of the Croatian Chamber of Economy (www.hgk.hr) provides a useful English-language guide, "How to Start Up an Enterprise in Croatia," as well as sector-specific and general reports. The Zagreb Stock Exchange's website (www.zse.hr) posts English-language translations of key laws in force.

[¶4.](#) Despite recent progress, however, problems remain that dampen investment in Croatia. Of these, the greatest is the country's legal system. Amid a backlog of over 1 million pending cases, even the simplest cases can take years to resolve. The result is that, in spite of laws that govern the sanctity of contracts, timely enforcement is a problem. The difficulty of obtaining timely judicial remedy in a dispute has hindered investment in Croatia. Other problem areas include inefficient bureaucracy and the country's relatively high costs in relation to other locations in Central and Eastern Europe.

[¶5.](#) The Agency for Trade and Investment Promotion has a mandate to match potential investors with projects in Croatia. The Agency has specialists available in strategic planning, investment support and export support (see www.apiu.hr) and is actively seeking projects that it can promote to foreign investors. The Agency is also active in advising the government on how to make Croatia's regulatory environment more transparent and competitive.

¶16. The Company Act defines the forms of legal organization for domestic and foreign investors. The following are permitted for foreigners: general partnerships, limited partnerships, branches, limited liability companies, and joint stock companies. The Obligatory Relations Law regulates commercial contracts.

A.2 Conversion and Transfer Policies

¶17. The Croatian constitution guarantees the free transfer and repatriation of profits and invested capital for foreign investments. Article VI of the U.S. Croatia Bilateral Investment Treaty (BIT) establishes protection for American investors from government exchange controls that limit current and capital account transfers, and limits on inward transfers made by screening authorities. The BIT obliges both countries to permit all transfers relating to a covered investment to be made freely and without delay into and out of each other's territory. The Croatian Foreign Exchange Law permits foreigners to maintain foreign currency accounts and to make external payments.

¶18. The Foreign Exchange Law also defines foreign direct investment (FDI). For example, use of retained earnings for new investments/acquisitions is considered FDI, whereas investments made by institutional investors such as insurance, pension and investment funds are not considered FDI. The law also liberalizes foreign exchange transactions for Croatian entities and individuals allowing them to invest abroad. Generally, this law liberalized foreign exchange transactions, but it also introduced criteria for the possible imposition of capital controls.

¶19. The U.S. Embassy in Zagreb has not received any complaints from American companies regarding transfers and remittances.

A.3 Expropriation and Compensation

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¶10. There have been no cases of expropriation of foreign investments by the government since Croatia became independent in 1991. Article III of the BIT covers both direct and indirect expropriations. The BIT bars all expropriations or nationalizations except those that are for a public purpose, carried out in a non-discriminatory manner, are in accordance with due process of law, and are subject to prompt, adequate and effective compensation.

¶11. Croatian law gives the government broad authority to expropriate property under various economic and security related circumstances. The law provides for an appellate mechanism to challenge expropriation decisions by means of a complaint to the Ministry of Justice within 15 days of the expropriation order. The law, however, does not describe the Ministry's adjudication process and the fact that the Ministry of Justice represents the government, which initiates expropriations, is an area of potential concern for investors.

A.4 Dispute Settlement

¶12. There have been few instances of investment disputes involving U.S. companies in Croatia. As a result of the very long timeframes involved in obtaining judgments in court, companies often try to resolve disputes without seeking judicial remedy. The government is currently working to reduce court backlogs and to encourage the use of alternative dispute settlement.

¶13. The Croatian constitution provides for an independent judiciary. The judicial system consists of courts of general and specialized jurisdictions, whose core structure is: Supreme Court, County Courts, Municipal Courts, and the Magistrate/Petty Crimes Courts. Specialized courts include the Administrative Court and High Commercial and Lower Commercial Courts. There is also a Constitutional Court that determines the constitutionality of laws and government actions and protects and enforces constitutional rights. Municipal courts exercise original jurisdiction over civil

and juvenile/criminal cases. The High Commercial Court is located in Zagreb and has appellate review of lower commercial court decisions. Modification of lower court decisions by the High Commercial Court may be appealed to the Supreme Court.

¶14. The Administrative Court has jurisdiction over the decisions of administrative bodies of all levels of government. The Supreme Court, under certain circumstances, may review decisions. The Supreme Court is the highest court in the country and, as such, enjoys jurisdiction over all civil and criminal cases. It hears appeals from County, High Commercial, and Administrative Courts.

¶15. The government continues efforts to reform the judiciary, including reducing the backlog of cases, reforming the land registry, training court officers and reducing the backlog and length of bankruptcy procedures. Alternative dispute resolution has been implemented at the High Commercial Court, the Zagreb Commercial Court and 6 municipal courts throughout the country. An important move to lessen the backlog of cases is the on-going redistribution of non-disputed decisions to public notaries. During the past year, the number of pending cases has decreased from 1.23 million cases to approximately one million. While the greatest reduction was in the backlog of enforcement cases, the enforcement of judgments continues to make up 25% of all pending cases. According to the provisions of the Law on Enforcement, a judgment made by a judge or panel of judges to order payment or direct actions to be taken or ceased must be executed immediately per such decision. Current practice, however, delays enforcement until all appeals are exhausted. Article 17 of the Law on Enforcement states that foreign judgments may be executed only if the "judgment fulfills the conditions for recognition and execution as prescribed by an international agreement or the law." The Ministry of Justice's reform plan is available on its website at www.pravosudje.hr.

¶16. The Law on Bankruptcy, internationally harmonized and corresponding to the EU regulation on insolvency proceedings and United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, establishes timeframes for the initiation of bankruptcy proceedings. Bankruptcy and foreclosures have traditionally been slow and inefficient in Croatia. A World Bank funded project, "Technical Assistance Associated with Bankruptcy Proceedings", ended in January 2007. The project had as its goal the advancement of company court administration through the introduction of an information and legal system for bankruptcy trustees, which was to assist in shortening bankruptcy proceedings. The World Bank has estimated that the recovery rate in Croatia is approximately 40 per cent of the Organization for Economic Cooperation and Development (OECD) average, and somewhat better than

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the regional average.

¶17. The Commercial Court has exclusive jurisdiction over bankruptcy matters. A bankruptcy tribunal decides on initiating formal bankruptcy proceedings, appoints the trustee, reviews creditor complaints, approves the settlement for creditors, and decides on the closing of proceedings. The bankruptcy judge supervises the trustee (who represents the debtor) and the operations of the creditors' committee. A creditors' committee is convened to protect the interests of all creditors during the proceedings, to oversee the trustee's work and to report back to the creditors. The law establishes the priority of creditor claims, assigning higher priority to those related to taxes and revenues of state, local and administration budgets. The law also allows for a debtor or the trustee to petition to reorganize the firm, an alternative aimed at maximizing asset recovery and providing for fair and equitable distribution among all creditors.

¶18. Arbitration is available, although underutilized. Within the Croatian Chamber of Economy, there is a permanent arbitration court that has been in existence since 1965. Arbitration is voluntary and conforms to UNCITRAL model procedures. The court reviews 30 to 40 cases per year, of which 40% are international cases.

¶19. The English-language text of the Law on Arbitration can be found on the website of the Croatian Chamber of Economy

(www.hgk.hr). The law covers domestic arbitration, recognition and enforcement of arbitration rulings, jurisdictional matters, and procedures. Once a dispute has been arbitrated the decision is executed upon notice from the court to the obligatory party. If no payment is made by the established deadline, then the party benefiting from the decision notifies the commercial court and the commercial court becomes responsible for enforcing compliance. Rulings of the arbitration court have the force of a final judgment, but can be appealed within three months.

¶20. Article X of the BIT sets forth several means for resolution of investment disputes, defined as any dispute arising out of or relating to an investment authorization, an investment agreement, or an alleged breach of rights conferred, created, or recognized by the BIT with respect to a covered investment. For more information on the BIT arbitration provisions, see http://tcc.export.gov/Trade_Agreements

¶21. Croatia is a signatory to the following international conventions regulating the mutual acceptance and enforcement of foreign arbitration: the 1923 Geneva Protocol on Arbitration Clauses, the 1927 Geneva Convention on the Execution of Foreign Arbitration Decisions, the 1958 New York Convention on the Acceptance and Execution of Foreign Arbitration Decisions, and the 1961 European Convention on International Business Arbitration. In 1998 Croatia ratified the Washington Convention - the International Center for the Settlement of Investment Disputes (ICSID), and it became effective on October 22, 1998.

A.5 Performance Requirements/Incentives

¶22. Croatia's WTO Trade Related Investment Measures (TRIMs) agreement went into effect in 2000. Croatia has no trade-related investment measures in place at the present time, nor does the government intend to introduce any such measures in the future. Accordingly, Croatia did not seek to list any measures for elimination under the provisions of the WTO Agreement on TRIMs. Croatia committed to maintaining measures consistent with the TRIMs agreement and has applied the TRIMs agreement from the date of accession without recourse to any transition period.

¶23. Croatian law does not impose performance requirements on foreign or domestic investors. Article VII of the BIT prohibits mandating or enforcing specified performance requirements as a condition for the establishment, acquisition, expansion, management, conduct, or operation of a covered investment. The list of prohibited requirements is exhaustive and covers domestic content requirements and domestic purchase preferences, the "balancing" of imports or sales in relation to exports or foreign exchange earnings, requirements to export products or services, technology transfer requirements, and requirements relating to the conduct of research and development in the host country. Article VII makes clear, however, that a party may impose conditions for the receipt or continued receipt of benefits and incentives.

¶24. In late 2004, the Ministries of Economy and Defense agreed to introduce offsets (a requirement for local sourcing of a portion of the contract) for defense procurements over 2 million euros, and the Ministry of Economy said it was looking at introducing offsets in other areas, however no such action has been undertaken.

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¶25. As of January 1, 2007, the Investment Promotion Law offers potentially significant incentives (the amount of which is dependent upon the percentage of unemployment in the respective county) to investors, foreign and domestic, such as 1500-3000 EUR incentive per new job position, assistance with retraining and tax incentives. It provides for incentives that apply only to investments in production based businesses, technological development centers and strategic business support activities. The minimum amount of investment that qualifies for incentives is 300,000 EUR. Tax incentives include substantially lower profit tax obligations and customs relief. The text of the law is available on the Croatian National Bank site (www.hnb.hr).

¶26. Incentives include: 10% corporate tax for ten years for companies that invest from 2.2 million to 11 million HRK (approximately \$440,000 - \$2.2 million) and create 10 new jobs; 7% corporate tax for ten years for companies that invest from 11 million to 30 million HRK (approximately \$2.2 million to \$6 million) and create 30 new jobs; 3% corporate tax for ten years for companies that invest 30 million to 58 million HRK (approximately \$6 million to \$11.6 million) and create 50 new jobs; 0% corporate tax for ten years for companies that invest over 60 million HRK (approximately \$11.6 million) and create at least 75 new jobs.

¶27. Incentive measures refer to investment in the following: new equipment and modern technology, new production processes and new products, greater employment and education of workers, modernization and growth of business, development of production with a higher level processing, an increase in exports, increasing economic activity in regions of Croatia in which economic growth and employment levels lag behind national averages (in accordance with the map of regional areas of special state concern), development of new services, energy conservation, strengthening information technology, cooperation with foreign financial institutions, and harmonizing the Croatian economy with EU standards.

¶28. Investors may also be eligible to receive assistance from the government to offset costs of employee re-training. The government may offer real estate (or permits or infrastructure) to an investment either cost-free or on a preferential basis. Finally, the government will allow the duty-free importation of capital equipment for the investment.

¶29. The Croatian government also offers concessions for business activity carried out in "areas of special state concern" (those areas most affected by the 1991-95 war). Activities in customs free zones are taxed at a lower corporate tax rate and concessions are awarded under the current Law on Free Zones. Also, for a period of ten years from when the Profit Tax Act was enacted in October 2003, no profit tax will be paid for business operations in those FTZs located in the Vukovar and Srijem Counties. However, although still in effect, some of these incentives are not in compliance with EU standards. The Government is currently studying how to bring them into compliance without reneging on previously-made commitments.

¶30. The Trade and Investment Promotion Agency can be helpful in identifying and applying for investment incentives. Also, the (separate) Office of Investment and Export Promotion in the Ministry of Economy can be helpful in looking for incentive information. Further information can be found on their website at www.mingor.hr.

¶31. Although procedures for obtaining business visas are generally clear, they can be cumbersome and time-consuming. Furthermore, the Government amended legislation during the summer of 2007, setting up new requirements for temporary residency. Article 56 of the Law on Foreigners now requires that a person seeking temporary residency for family members must, themselves, have been in Croatia for at least two years before such residency would be issued to their family members. At the time of the writing of this report, it is still unclear how this law will be implemented or may be amended in the future. Questions relating to visas and work permits should be directed to a Croatian embassy or consulate. The US Embassy in Zagreb also maintains a website with information on this subject at www.usembassy.hr.

A.6 The Right to Private Ownership and Establishment

¶32. Both foreign and domestic legal entities have the right to establish and own businesses and engage in remunerative activity. Foreign investors can acquire ownership and shares of joint stock companies. The lowest amount of initial capital for establishing a joint stock company is 200,000 HRK (\$40,000) and the nominal value per share cannot be less than 10 HRK (\$2.00). Minimum initial capital for establishment of a limited liabilities company is 20,000

HRK (\$4,000), while individual representation per investor cannot be less than 200 HRK (\$40.00)

133. Article 49 of the Constitution provides assurances that all entrepreneurs have equal legal status and that monopolies are forbidden. The Competition Act defines the rules and methods for promoting and protecting competition. This law and information about the Croatian Competition Agency can be found at www.aztn.hr. In theory, competitive equality is the standard applied to private enterprises in competition with public enterprises with respect to market access, credit and other business operations, such as licenses and supplies. In practice, however, state-owned enterprises and "strategic" firms continue to receive preferential treatment, including government bailouts and subsidies.

134. The Government's e-government initiative "HITRO" (www.hitro.hr) became operational in 2005, with an on-line business registration component that reduces the time it takes to register a company to four days. Business registration is the first step in a plan to make more government services available on-line in coming years and includes the full digitization of Croatia's land records (see www.pravosudje.hr and www.kataster.hr to find digitized land records).

A.7 Protection of Property Rights

135. The right to ownership of private property is established in the Croatian Constitution and numerous acts and regulations safeguard this right. A foreign physical or legal person incorporated under Croatian law is considered to be a Croatian legal person. The Law on Ownership and Property Rights establishes procedures for foreigners to acquire property by inheritance as well as legal transactions such as purchases, deeds, and trusts. The right of foreigners to acquire property in Croatia is based on reciprocity. Reciprocity exists on state-by-state basis with the United States. Croatia's Ministry of Foreign Affairs has confirmed the existence of reciprocity for real estate purchases for residents of the following states: Alabama, Arizona, Alaska, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Louisiana, Maine, Massachusetts, Michigan, Montana, Nevada, New Jersey, New York, North Carolina, North Dakota, Rhode Island, Tennessee, Texas, Virginia, Washington, West Virginia, Iowa and Oklahoma (with a condition of permanent residence). Residents of other states could face longer waiting periods while the Ministry confirms that Croatian nationals can purchase real estate in those states without restrictions. However, a foreign investor, incorporated as a Croatian legal entity, may acquire/own property without ministry approval. Purchasing by any private party of certain types of land (principally land directly adjacent to the sea or in certain geographically designated areas) can be restricted. Both Croatian and foreign citizens may mortgage property and pledge real and tangible property.

136. In order to acquire property by means other than inheritance or as an incorporated Croatian legal entity, foreign investors require the approval of the Ministry of Justice. Approval often takes several months or longer owing to a lengthy interagency clearance process.

137. Clarifying Croatia's land registry system is an on-going process and, while Croatia has made progress resolving a backlog of cases, potential investors should seek a full explanation of land ownership rights before purchasing property. It is highly advisable to seek competent, independent legal advice in this area (see www.usembassy.hr, Consular section for a list of English-speaking attorneys), as there are sometimes ambiguous and conflicting claims to property, making it necessary to verify that the seller possesses clear title to both land and buildings, which can be titled and owned separately. Inheritance laws have led to a situation in which some properties can have dozens of legal owners, some of whom are long since deceased and others of whom emigrated and cannot be found. It is also important to verify the existence of necessary building permits, as some newer structures in coastal areas have been subject to destruction at owner's expense and without compensation for not conforming with local zoning regulations. Investors should be particularly wary of promises that structures built without permits will be regularized retroactively.

¶38. Some aspects of land ownership, as distinct from ownership of objects, are not clear. Investors interested in acquiring companies from the Croatian Privatization Fund should seek expert legal advice to determine whether any deal also includes the right to ownership of the land on which an object is located, or merely the right to lease the land through a concession. The various Croatian laws on privatization are not clear on this point.

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¶39. Inconsistent regulations and restrictions on coastal property ownership and construction have in the past provided challenges for foreign investors. Legislation passed in 2004 restricts coastal construction and commercial use within 70 meters of the coastline.

¶40. Croatia has intellectual property rights legislation, including the Patent Law, Trademark Law, Industrial Design Law, Law on the Geographical Indications of Products and Services, Law on the Protection of Layout Design of Integrated Circuits, and Law on Copyrights and Related Rights. Although some areas of IPR protection remain problematic, Croatia has shown improvement and was consequently removed from the U.S. Special 301 Watch List in 2007. Problem areas continue to be concentrated in piracy of digital media and counterfeiting. Croatia is also a transit country for contraband shipments bound for other countries in the region.

¶41. As a full WTO member, Croatia is a party to the Uruguay Round Agreement on Trade-Related Intellectual Property Rights (TRIPS). A WTO/TRIPS Working Group in June 2001 accepted Croatia's IPR legislation. Texts of these laws are available on the website of the State Intellectual Property Office: www.dziv.hr. Croatia is also a member of the World Intellectual Property Organization (WIPO). For a list of international conventions to which Croatia is a signatory, consult the State Intellectual Property Office's website.

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